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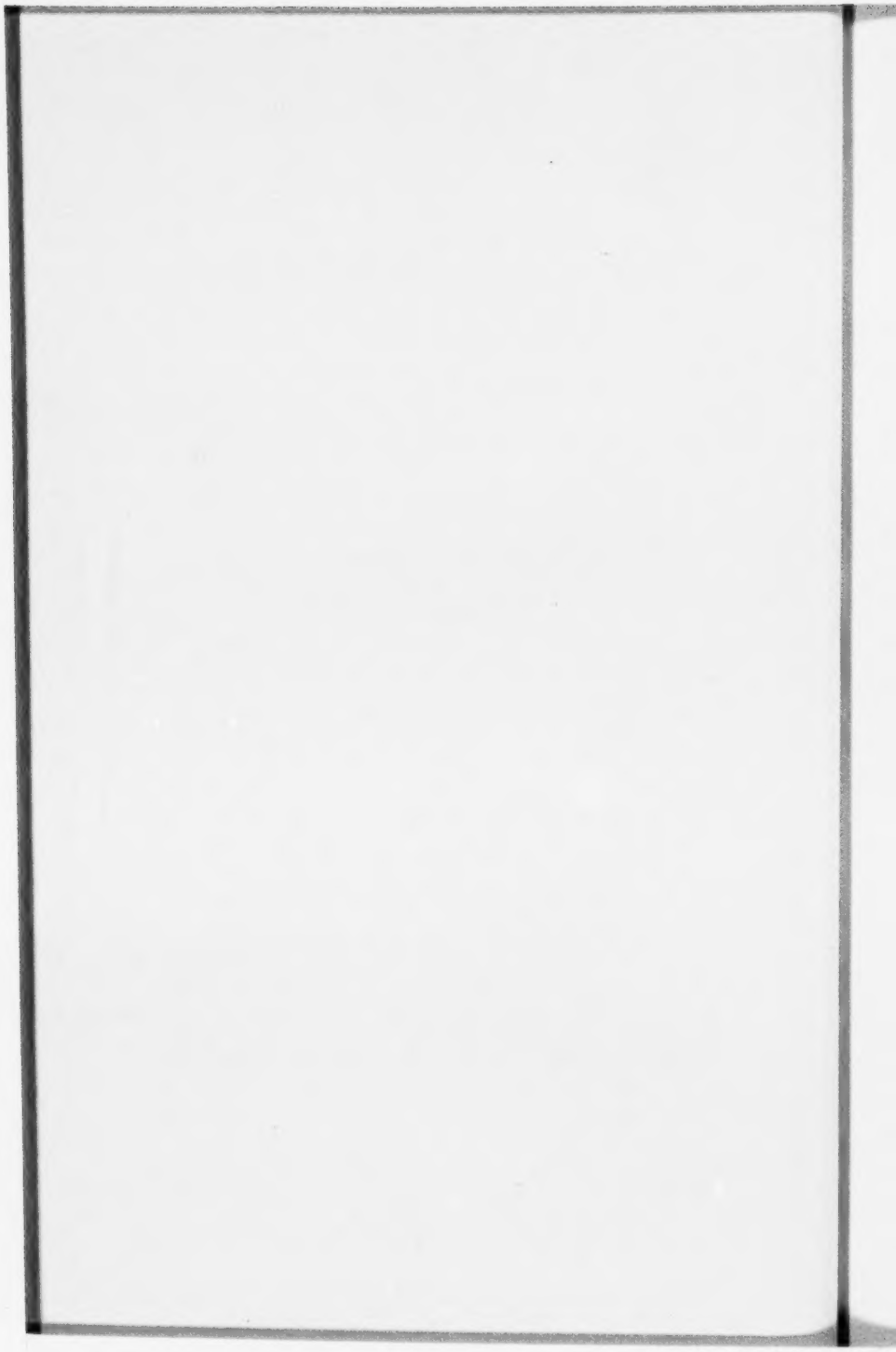

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 634

GEORGE COTROS ET AL., PETITIONERS

v.

NASHVILLE TRUST COMPANY, EXECUTOR UNDER THE WILL OF CHARLES M. MCCABE, FORMER COLLECTOR OF INTERNAL REVENUE FOR THE DISTRICT OF TENNESSEE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The opinion of the District Court of the United States for the Middle District of Tennessee (R. 68–76) is not officially reported. The opinion of the Circuit Court of Appeals (R. 86–90) is reported in 120 F. (2d) 157.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Sixth Circuit was entered June 5, 1941 (R. 85). A petition for a rehearing, or to amend the decree, was filed June 30, 1941 (R. 91–95), and on August 15, 1941, the Circuit Court of Appeals entered an order amending the mandate (R. 97). The petition for a writ of certiorari was filed September 22, 1941. The jurisdiction of this Court is conferred under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxpayers operating under an indenture of trust constituted an association taxable as a corporation within the meaning of Sections 801 (a) (2) and 1001 (a) (2) of the Revenue Acts of 1934 and 1936, respectively.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra,* pp. 10–15.

STATEMENT

The findings of the District Court together with the contents of the exhibits may be summarized as follows (R. 68–76, 80):

In August 1933 the Lincoln Oil Company, Inc., a corporation engaged in developing oil property, conveyed an undivided one-third interest in a leasehold of certain Louisiana oil lands to George

Cotros, John A. Papageorge, and Nick Taras, of Memphis, Tennessee. Cotros, Papageorge, and Taras agreed to defray one-third of all the necessary expenses incurred by the oil company in drilling and developing oil wells upon the property until discovery of oil, and in fact did pay $20,000 in cash, which was their estimated share. After the discovery of oil the maintenance, operation, and production expenses were to be paid from the oil revenues and defrayed in proportion to the interests held by the respective parties (R. 69). The Lincoln Oil Company also agreed to keep the three grantees fully advised as to the work being done in the way of drilling, to accord them a full accounting of all expenses, furnishing a complete statement and making available at all times the books and records pertaining to the operations, and to supply the grantees with a complete log and samples of cores on each well (Ex. "D," R. 80).

Shortly after the conveyance, the Lincoln Oil Company began drilling operations (R. 70). On or about February 14, 1934, Cotros, Papageorge, and Taras executed a revocable power of attorney authorizing the oil company to transact all necessary business pertaining to the drilling of wells, payment of expenses, and collection of revenues. All of the oil wells in question were drilled by the company without any further assistance from the three grantees (R. 73). But before completion of the discovery well, Cotros, Papageorge, and Taras

decided that they did not wish to venture the entire $20,000 themselves (R. 70).

Accordingly, on April 17, 1934, Cotros, Papageorge, and Taras entered into a participation agreement with more than twenty of their friends. In the agreement it was expressly provided that the three grantees, in whose name title to the leasehold interest stood, were trustees for the benefit of all parties whose names were annexed to the instrument and that they were given full power and control of the leasehold interest, to manage it as they saw fit, to sell or transfer it at any time and for any amount which to them seemed proper (R. 26, 70–71). It was also provided that the parties whose names were annexed to the instrument, excluding Cotros, Papageorge, and Taras, were entitled to share in the net profits derived from the production of oil, gas, or minerals from the leasehold interest in proportion as the amounts set opposite their respective names stood in relation to the sum of $20,000, and that Cotros, Papageorge and Taras were entitled to share equally in the remaining net profits (Ex. "B," Items 1, 2, R. 25). In return, the parties whose names were annexed to the instrument agreed to pay to the three trustees the sums set opposite their names (Ex. "B," Item 5, R. 26). The parties who signed the agreement other than Cotros, Papageorge, and Taras, numbered twenty-one, and the total funds which they advanced amounted to $4,150 (R. 71–72). They

were not furnished certificates or evidences of ownership (R. 72–73). Subsequently, at least two of the parties transferred their interests to third persons (R. 73).

After the Lincoln Oil Company completed its first well, it drilled two additional wells (R. 73). When the wells started producing, the share of the net revenues belonging to the taxpayers was forwarded to the trustees by check of the Lincoln Oil Company. These checks were deposited in a bank. Pro rata distribution to the parties who signed the agreement of April 17, 1934, was then made by an employee of the company of which Mr. Cotros was president (R. 73). Cotros, Papageorge, and Taras had no books other than the pass book furnished them by the bank where the oil revenues were deposited and a check book evidencing payment of the pro rata distributions (R 73). Only one meeting was held by the parties: when the Lincoln Oil Company offered to purchase their one-third leasehold interest, the parties were called together and decided to decline the offer (R. 73).

On February 4, 1938, the Collector of Internal Revenue collected from the taxpayers capital stock tax, interest, and penalties for the years 1934 to 1937, inclusive, and also corporate income and excess profits taxes for 1934 and 1935, all of which were paid under protest (R. 74).[1] Taxpayers contended

[1] The portion of taxes representing excess profits tax and interest is not in issue here.

that they did not constitute an association taxable as a corporation, and therefore were not subject to a capital stock tax, corporate income tax, or excess profits tax (R. 74–75). After filing appropriate claims for refund, they brought suit in the District Court, which held that the taxpayers did not constitute an association and entered judgment in their favor (R. 77–78). The court below reversed (R. 85, 97).

ARGUMENT

The basic principles for ascertaining whether this trust is an association taxable as a corporation have already been outlined by this Court in four companion cases. *Morrissey* v. *Commissioner,* 296 U. S. 344; *Helvering* v. *Coleman-Gilbert Associates,* 296 U. S. 369; *Swanson* v. *Commissioner,* 296 U. S. 362; *Helvering* v. *Combs,* 296 U. S. 365. Here the taxpayers' request for certiorari rests upon the contention that the court below has misapplied these principles to the particular facts. We submit that the decision is in accordance with the established law and that there is no conflict with the decisions of other circuits.

As pointed out by the court below (R. 88–90), this case is governed by *Helvering* v. *Combs.* In each case a trust was created by an indenture, and the object of each trust was to participate in the development of oil wells. It is true here that Cotros, Papageorge, and Taras had originally undertaken to carry their share of the expenses alone,

but the purpose of the subsequent trust arrangement was to spread it among a larger group of participants (R. 24–25). The existence of a regular business purpose is thus made plain. In both cases the functions actually performed by the trustees were limited;[2] but the issue is not whether the trustees were themselves active. Persons engaged in any business may act through agents, and here the Lincoln Oil Company, Inc., managed and operated the taxpayers' share of the leasehold by virtue of a power of attorney executed by the trustees.[3] Although taxpayers urge that the trust arrangement should not be classed as an association because liability of the participants for business losses is not limited to the amount of their investment, that position appears untenable; the indenture here closely resembles that of the *Combs* case in respect of limitation on liability—in neither case did the participants obligate themselves beyond their original contribution—and this Court plainly stated that the participants there "* * * avoided the characteristic responsibilities of partners and secured advantages analogous to those which pertain

[2] In this connection it should be noted that in the *Combs* case, prior to the formation of the trust, the parties had entered into an agreement by which a driller took full responsibility for sinking the well in consideration of a percentage of the oil. (Record, *Helvering* v. *Combs*, October Term, 1935, No. 238, pp. 36–42.)

[3] As the Circuit Court of Appeals has noted, the fact that the power of attorney antedated the trust agreement is of no significance, since it was revocable at any time (R. 90).

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to corporate organization. * * *" (296 U. S. 365, at 368–369).

There appears to be only one relevant distinction from the situation in *Helvering* v. *Combs*; here no formal certificates of interest were issued to the participants. However, as this Court stated in *Morrissey* v. *Commissioner*, "* * * the test of an association is not to be found in the mere formal evidence of interests or in a particular method of transfer." (296 U. S. 344, at 358.)

There is no conflict with *Lewis & Co.* v. *Commissioner*, 301 U. S. 385, as alleged. In that case there was no group of persons associated in a business enterprise. There the trust form was adopted by a single landowner for the benefit of herself and her husband.

The taxpayers urge also that the decision below is in conflict with five decisions of circuit courts of appeals. Those and the remaining cases upon which the taxpayers rely represent a class of decisions which this Court has persistently declined to review. See Government's petition for certiorari in *Helvering* v. *Cleveland Trust Co.*, No. 764, October Term, 1940, certiorari denied, 312 U. S. 704; *Lee H. Marshall Heirs* v. *Helvering*, No. 110, October Term, 1940, certiorari denied, 311 U. S. 658; *Kettleman Hills Royalty Syndicate No. 1, a Trust*, v. *Helvering*, No. 958, October Term, 1940, certiorari denied, May 26, 1941.

CONCLUSION

The decision of the court below correctly applies to the facts of this case the statute and the governing principles established by decisions of this Court. There is no conflict of decisions. The petition should be denied.

Respectfully submitted.

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OCTOBER 1941.